SUPREME COURT, U.S.
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No. 89-1859 (2)

In the Supreme Court of the United States

OCTOBER TERM, 1990

ALBERT J. DEANGELIS, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner, a tippee who purchased securities while in possession of material, nonpublic misappropriated information, acted with the requisite scienter or other culpability to establish a violation of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(e), and Rules 10b-5 and 14e-3 thereunder, 17 C.F.R. 240.10b-5 and 240.14e-3.

2. Whether the district court abused its discretion in permanently enjoining petitioner from future securities law violations, ordering the disgorgement of his insider trading profits, and awarding prejudgment interest.

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2 W. LaFave & A. Scott, *Substantive Criminal Law* (1986) 10

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OPINIONS BELOW

The order of the court of appeals (Pet. App. 1a-2a) affirming the judgment of the district court is unreported, but the judgment is noted at 898 F.2d 138. The opinion of the district court (Pet. App. 3a-29a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 22, 1990. The petition for a writ of certiorari was filed on May 23, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. In the early 1980s, Alan Ihne was employed as the manager of office services at the Wall Street law firm of Sullivan & Cromwell. During that time, Sullivan & Cromwell rendered confidential legal advice to certain clients concerning anticipated extraordinary corporate transactions, including tender offers. Ihne, in breach of his fiduciary duties, repeatedly misappropriated information from Sullivan & Cromwell and its clients concerning these transactions and improperly shared that information with a friend, Joseph Palomba, and the friend's stockbroker, James Stivaletti. Those three conspired to profit from securities trading based on Ihne's stolen information. Pet. App. 4a, 17a.

In order to avoid detection, Stivaletti recruited Dominick Musella, the brother of a college classmate, to make securities trades for the group using the stolen information. Musella was the owner of the "Swirl & Curl" beauty salon in Brooklyn, New York. Stivaletti agreed to provide Musella with the names of the securities to be purchased in return for a share of the profits derived by Musella from trading on the information. Thereafter, Ihne would misappropriate information from his law firm, and Stivaletti would call Musella with directions on which securities to purchase. Stivaletti advised Musella to spread his trading among different accounts and, if possible, in accounts under different names. On several occasions, Musella met with Stivaletti in Musella's automobile in front of a diner late at night to discuss their arrangement. During one such meeting, Musella paid Stivaletti a share of the profits by handing him an envelope containing $18,000 in cash. Pet. App. 5a-6a, 11a-12a.

Although Musella pressed Stivaletti to identify the source of his information, Stivaletti refused to do so. Thereafter, Musella began to refer to the source as "The

Goose that Laid the Golden Egg." At one of their clandestine meetings, however, Musella showed Stivaletti a magazine article about illegal insider trading which described different sorts of persons (including lawyers, secretaries, and printers) who could have access to inside information. The article also contained a cartoon depicting the various sources of illegally obtained confidential information. Stivaletti, referring to the cartoon, told Musella that his source was "one of those." Pet. App. 5a-6a, 11a-12a; SEC C.A. Br. 8.

b. Petitioner, the President of Local 875, International Brotherhood of Teamsters, was a close friend of Musella's for over 20 years. The two spoke at least two or three times a week, "discuss[ing] everything * * * that two people can discuss." Shortly after Musella had made his first profitable securities purchase based on Stivaletti's information, Musella began to share certain of Stivaletti's tips with petitioner. Petitioner then traded in the stock or options of three companies based on information obtained from Musella, reaping substantial profits.[1] As to one com-

[1] In particular, on October 29, 1981, petitioner purchased 120 call options on Marathon Oil Company stock and sold them within two weeks, after the announcement of a tender offer for Marathon, for a profit of $268,513. In November 1981, petitioner purchased 3,000 shares of Penn Central Corporation stock and sold them within one week for a profit of $4,661. In February 1982, petitioner purchased 12,700 shares of Signode Corporation stock (investing $518,868) and sold the shares in early March 1982 for a profit of $89,617. In the Marathon transaction, Sullivan & Cromwell represented the investment banker for the tender offeror; Ihne provided stolen information about the upcoming transaction to Stivaletti, who relayed instructions to Musella to purchase call options. Petitioner purchased call options that same day. Similarly, Sullivan & Cromwell represented the investment banker for a potential bidder for Penn Central; Ihne again misappropriated the information and informed Stivaletti, who in turn told Musella to buy Penn Central shares. Petitioner bought Penn Central shares a few days later. Finally, Sullivan & Cromwell represented the

pany, Signode Corporation, petitioner strongly recommended to the son of a close friend that he purchase the stock "because * * * it was a possible takeover possibility." The son, who was a sophisticated investor, concluded that petitioner's information was confidential and came from "people that knew something about what was going on." Pet. App. 10a, 12a; SEC C.A. Br. 7 n.4, 9, 12 & n.8.

Shortly after purchasing a significant number of call options on Marathon Oil Company stock based on discussions with Musella, petitioner was contacted by a Securities and Exchange Commission (Commission) investigator looking into suspicious trading in Marathon. In response to a direct inquiry, petitioner falsely denied knowing Musella. Petitioner was later subpoenaed to appear before the Commission in an investigation relating to Marathon, but he invoked his Fifth Amendment privilege and refused to testify. Pet. App. 13a.

2. In a civil action brought by the Commission, the district court held that petitioner's trading violated Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(e), and Rules 10b-5 and 14e-3 thereunder, 17 C.F.R. 240.10b-5 and 240.14e-3.[2] Prior to trial, the Commission and petitioner stipulated

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investment banker in a management buy-out of Signode; Ihne's information about the proposed transaction was communicated to Stivaletti who again communicated with Musella. Petitioner began purchasing Signode that same day. Pet. App. 6a-10a; SEC C.A. Br. 9-13.

[2] The Commission's amended complaint alleged violations by 15 defendants in connection with the information stolen by Ihne. By the time of his trial, petitioner was the only remaining defendant. The other defendants (apart from Musella who died in 1984) either consented to judgments or had summary judgments entered against them. See *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (entering preliminary injunction against certain defendants); *SEC* v. *Musella*, 678 F. Supp. 1060 (S.D.N.Y. 1988) (entering summary judgment against certain other defendants); SEC C.A. Br. 15 n.12.

that Ihne had stolen confidential information from Sullivan & Cromwell; that Ihne shared the stolen information with Palomba and Stivaletti; that the three had agreed to trade on the information and split profits; that Musella and petitioner were close personal friends who spoke to each other frequently; and that Musella and petitioner made profits by trading in stock or options of Marathon, Penn Central, and Signode. SEC C.A. Br. 15-16.

Based on the stipulated facts and the evidence at trial, the district court found that Ihne had breached a duty of trust and confidence he owed his law firm and its clients by stealing confidential information; that the information was material; that Ihne gave the information to Stivaletti, who, in turn, enlisted Musella and directed him to make purchases based on Ihne's misappropriated information; that Musella transmitted the misappropriated information to petitioner; and that petitioner had traded while in possession of such information. Pet. App. 16a-17, 23a.

The district court further concluded that petitioner had the requisite scienter to sustain liability under Section 10(b) and Rule 10b-5. Noting that those provisions are violated when a tippee "knows or is reckless in not knowing that he was trading on misappropriated non-public information," Pet. App. 18a, the court found that the evidence met that standard with respect to petitioner. The court initially found that petitioner's tipper, Musella, "knew that the information was illegally obtained from an inside source," even without knowing the source's name. In support of that conclusion, the court pointed to Musella's reference to the source as "The Goose that Laid the Golden Egg," the fact that he engaged in covert meetings with Stivaletti, and his payment of profits in cash. The court also relied on Musella's conversation with Stivaletti about the insider trading article and cartoon depicting various sources of information, in which Stivaletti ad-

mitted that his information came from one of the inside sources shown. *Id.* at 17a.

The court further found that "Musella relayed the stolen, non-public information from Sullivan & Cromwell to [petitioner] and that [petitioner], in turn, knew or should have known that he was trading on stolen, non-public information." Pet. App. 18a-19a.[3] This finding flowed from the correlation between petitioner's trading activity and Musella's receipt of information from Stivaletti, *id.* at 12a, 19a; the large amounts of money petitioner invested in these securities compared with his previous activities and his "confidence that these investments would 'pan out,' " *id.* at 20a; the implausibility and inconsistency of petitioner's explanations for his investments, which the court rejected as "inconsistent with the facts," "beyond credulity," and "manufactured," *id.* at 20a-21a; the fact that a person tipped by petitioner formed the view that petitioner's information was nonpublic and had been obtained from a knowledgeable source, *id.* at 21a; and the inference of consciousness of guilt arising from petitioner's lie to the Commission's investigator when asked if he knew Musella, *id.* at 22a-23a.

The court also concluded that petitioner violated Section 14(e) and Rule 14e-3 by purchasing Marathon options and Penn Central stock while in possession of nonpublic information concerning tender offers. Pet. App. 23a-26a. The court explained that in light of the evidence, petitioner "knew or should have known that he was in possession of material non-public information about pending tender of-

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[3] The court noted that "[e]ven if Musella never expressly told [petitioner] what the source of his information was, the success of Musella's information and its unlikely source (Musella) at a minimum put [petitioner] on notice to question the origin of the information." Such "conscious avoidance * * * does not defeat *scienter*." Pet. App. 19a n.5.

fers" that was obtained from a source covered by the rule. *Id.* at 26a.

Having found insider trading violations, and in light of the "degree of *scienter* involved," the district court permanently enjoined petitioner from violating Sections 10(b) and 14(e) and Rules 10b-5 and 14e-3; ordered him to disgorge his insider trading profits; and awarded prejudgment interest. Pet. App. 27a-28a.

3. The court of appeals affirmed the district court's decision in an unpublished, memorandum order "substantially for the reasons stated in [the district court's] thorough opinion." Pet. App. 2a.

ARGUMENT

1. Petitioner's principal contention (Pet. 8, 10-11) is that the evidence failed to show that he acted with the requisite scienter or other culpability to violate Rules 10b-5 and 14e-3 as a tippee. He argues that his conduct fell outside the reach of those provisions because he "did not know and did [not] have the ability to find out the source of the information, where the source was employed or the nature of the source's occupation or that the information was obtained via a violation of fiduciary duty to an employer." Pet. 10. Petitioner's argument essentially challenges the factual finding, endorsed by both courts below, that petitioner did know or have reason to know he had traded on misappropriated, nonpublic information.[4] Because that finding is correct, and does not conflict with any decision of this Court or with that of any other court of appeals, this Court's review is not warranted.

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[4] Such factual issues, in which two courts have concurred, warrant no review here. See *United States* v. *Doe*, 465 U.S. 605, 614 (1984); *United States* v. *Reliable Transfer Co.*, 421 U.S. 397, 401 n.2 (1975); *Berenyi* v. *Immigration Director*, 385 U.S. 630, 635 (1967).

a. As the district court noted, Rule 10b-5 is violated when a tippee "knows or is reckless in not knowing that he [is] trading on misappropriated non-public information." Pet. App. 18a. Cf. *Dirks* v. *SEC*, 463 U.S. 646, 660 (1983). This Court has recognized that circumstantial evidence will often be the only way to establish the defendant's scienter. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 390 n.30 (1983). In this case, the circumstantial evidence was sufficient to support the district court's finding that petitioner knew that the nonpublic information he received from Musella had been obtained unlawfully.[5]

Musella, petitioner's immediate tipper, was recruited by Stivaletti to participate in a clandestine securities trading scheme. Stivaletti met with Musella in parked cars late at night, accepted payments in large amounts of cash, and counseled Musella to spread his trades across many accounts, if possible in different names. Indeed, although he would not name his source to Musella, Stivaletti acknowledged to Musella that his source was one of the types of persons identified in a cartoon (in an article about insider

[5] The district court concluded that even if Musella had not informed petitioner of the specific details of his conversations or dealings with Stivaletti, petitioner was still aware that the origins of the information were suspect, given the accuracy of the information in identifying companies that were involved in extraordinary business transactions. Pet. App. 19a n.5. In view of the circumstances, petitioner's failure to make inquiries of Musella amounted at least to "conscious avoidance" of the truth—a showing long understood to satisfy even the demanding knowledge requirements applied in the criminal context. See, *e.g.*, *United States* v. *Lanza*, 790 F.2d 1015, 1021-1022 (2d Cir.), cert. denied, 479 U.S. 861 (1986). The same principles apply here. See *SEC* v. *Musella*, 678 F. Supp. at 1063 ("I cannot accept that conscious avoidance of knowledge defeats scienter in a stock fraud case, any more than it does in the typical *mens rea* criminal context. To hold otherwise would subvert the laws against fraudulent trading in securities.").

trading that Musella was reading) who had access to such information because of the persons' employment. Musella thus learned that the information was procured in a breach of duty, and his close relationship with petitioner as well as the nature of petitioner's trading supports the inference that petitioner learned the same information.[6] Indeed, petitioner confidently recommended to another individual the purchase of stock in Signode based on Musella's information, predicting that the company was "a possible takeover possibility." The recipient of that information was impressed that petitioner "was getting his information from 'people that knew something about what was going on with the particular instruments . . . someone that did know what was happening,' " based on nonpublic information. Pet. App. 10a. Against that background, the record amply supports the finding that petitioner's trading was knowingly based on information obtained via the breach of duty by one with access to sensitive corporate information.

Petitioner contends (Pet. 10) that he is immunized from liability under Rule 10b-5 because he did not know the actual employment relationship from which the nonpublic information was misappropriated. Such a position, if accepted, would frustrate the policies underlying the prohibition against trading on misappropriated information. For good reason, it is hornbook law that the recipients of stolen property are liable without specific knowledge of

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[6] Petitioner's willingness to commit large sums of money to purchase securities based on Musella's tips reflected petitioner's belief that the person from whom the information had been obtained had special and reliable access to such information. See Pet. App. 26a. And petitioner's attempt to deceive an SEC investigator by denying that he knew Musella supports the court's finding that petitioner was conscious that the information on which he traded was improperly obtained. *Id.* at 22a-23a.

the origins of the property. See *United States* v. *Werner*, 160 F.2d 438, 441 (2d Cir. 1947) (L. Hand, J.) ("The receivers of stolen goods almost never 'know' that they have been stolen, in the sense that they could testify to it in a court room."); 2 W. LaFave & A. Scott, *Substantive Criminal Law* § 8.10, at 428 (1986). A similar principle applies to petitioner's trading on stolen information, particularly because misappropriation of confidential information is a form of theft. See *Chiarella* v. *United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting) ("Chiarella * * * misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence."). To adopt a contrary rule would create a safe harbor for a sophisticated insider trader with a network of well-connected friends; all the tippee would have to do is turn a blind eye to the details about the specific source of the information. Not only would such a requirement undermine enforcement of the securities laws, it would exonerate an individual like petitioner who had ample reason for knowing that his conduct was unlawful.[7]

[7] The Second Circuit recently reversed a conviction in a criminal insider trading case because, according to the court, there was "no evidence that [the tippee] knew that [the source] was breaching a confidential relationship by imparting the information to him." *United States* v. *Chestman*, 903 F.2d 75, 79 (2d Cir. 1990), petition for rehearing, with suggestion for rehearing en banc, pending, No. 89-1276. We disagree with *Chestman*'s implication that evidence must be introduced to establish that the tippee had knowledge of the specific confidential relationship that was breached. Regardless of any tension between *Chestman* and the result here, however, this Court's review of the issue would be premature. No other court of appeals has addressed the precise requirements for establishing tippee scienter, and the result in this case is correct. Moreover, the government has asked the Second Circuit to grant rehearing en banc in *Chestman* to clarify the principles applicable to proving tippee scienter under Rule 10b-5.

Contrary to petitioner's contention (Pet. 11), the result in this case does not conflict with this Court's decision in *Dirks* v. *SEC, supra*. That case stated that a tippee of nonpublic information by a corporate insider is not liable unless the insider's disclosure of information breaches a fiduciary duty, and the "tippee knows or should know that there has been a breach." *Dirks*, 463 U.S. at 660. In this case, the district court found that petitioner was aware of (or consciously avoided learning) the facts known to Musella, who did know of a breach of duty; hence, even assuming that *Dirks* fully applies in a misappropriation case, its standards were satisfied. In any event, *Dirks* does not hold that a tippee must know the specific details of the confidential relationship that was breached in obtaining the information.[8]

[8] In discussing the requisite knowledge for tippee liability the Court noted in *Dirks* that "[t]he issue in this case, however, is not whether [the tipper] or [the tippee] acted with scienter, but rather whether there was any deceptive or fraudulent conduct at all[.]" 463 U.S. at 663 n.23. Thus, *Dirks* cannot be read to require that a tippee be aware of the specifics of the tipper's improper acquisition or disclosure of nonpublic information. Nor does language discussing tippee scienter in *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 313 n.22 (1985), support such a requirement. That case was addressed to the quite different issue whether the doctrine of *in pari delicto* barred a tippee from recovering from his tipper under Rule 10b-5, not the circumstances under which tippees may be held liable under the rule.

Petitioner also gains no support from *SEC* v. *Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984). Pet. 11-12. In that case, the court concluded that the tipper had not disclosed the information to the tippee for an "improper purpose" and, thus, an essential predicate for tippee liability was absent. 590 F. Supp. at 766. The court went on to find, on the particular facts, that the tippee did not know or have reason to know of any breach by an insider. *Ibid*. But the tippee in *Switzer* did not engage in a pattern of trading immediately before the announcement of extraordinary corporate transactions (as petitioner did here), make covert cash payments (as Musella did), or deceive a Commission investigator (as petitioner did).

b. Petitioner errs in contending (Pet. 10) that he could not be found liable under Rule 14e-3 because he "neither knew or had the ability to find out that the information was material, non-public information imparted by a proposed tender offeror or its agent." Rule 14e-3 provides that if a person is in possession of material information relating to a tender offer, "which information he knows or has reason to know" is nonpublic and was acquired, directly or indirectly, from the bidder, the target, or a person acting on either's behalf, he is forbidden to trade in the securities or options of the companies involved. 17 C.F.R. 240.14e-3(a). As the district court explained, petitioner was a "sufficiently sophisticated investor" to have understood that Musella's information was derived from a proscribed source relating to a tender offer. Petitioner knew or should have known that "he had inside information about proposed tenders offers," and, from the nature of that information, he "necessarily must have known that the source of his information was either the acquiring company or the target company, or someone acting on behalf of one of those companies." Pet. App. 26a.[9]

2. Petitioner's challenge to the relief granted by the district court need not detain the Court. Although included in the questions presented (Pet. i), the issue is discussed only briefly and cryptically in the petition, Pet. 12, and that discussion does not indicate why petitioner be-

[9] Petitioner raises no issue with respect to the validity of Rule 14e-3, an issue recently addressed by the Second Circuit in *United States* v. *Chestman, supra*. There, a splintered panel was unable to agree whether Rule 14e-3 requires a breach of a fiduciary duty as a precondition of liability, and, if it does not, whether the rule is valid. The government has requested the court of appeals to rehear *Chestman* en banc to resolve whether Rule 14e-3 is valid and whether it requires a breach of fiduciary duty. In any event, that issue is of no concern to petitioner because the information communicated to him was obtained in breach of a fiduciary duty. Pet. App. 16a-17a.

lieves the grant of relief was improper or provide any reason for this Court's review of that issue. The equitable relief granted by the district court was well within its discretion to remedy securities law violations. See, *e.g.*, *SEC* v. *Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987) (injunction and disgorgement), cert. denied, 486 U.S. 1014 (1988); *Rolf* v. *Blyth, Eastman Dillon & Co.*, 637 F.2d 77, 86 (2d Cir. 1980) (prejudgment interest).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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